STRAITS & ISLAND GENERAL INSURANCE SDN. BHD.

v.

LAWRENCE CHUNG HEE MENN & ORS.

HIGH COURT BORNEO, KOTA KINABALU
SYED AHMAD IDID JC
[CIVIL SUIT NO. K178 OF 1989]
16 JANUARY 1991

COMPANY LAW: *Directors - Constructive trustees - Agency - Agreement with third party - Fiduciary duty to third parties - Companies Act 1965, s. 354.*

The plaintiffs, P who were licensed insurers, appointed K as their agent. The 1st, 2nd and 3rd defendants D1, D2 and D3 were directors of K. P contended that K had received payments as their agent and as such, the defendants, as director of K, held these monies as constructive trustees for P.

The defence was that the relationship between P and K was of debtor and creditor; even if there was a trust, the defendants were not personally liable for K's undertaking nor was there a duty on their behalf to give preference to any particular creditor of K. Even if the directors had acted wrongly, their liability was to K and not to P as P are third parties to whom the directors owe no direct duty.

Held:

[1](a) Directors are deemed to be constructive trustees only as far as their relationship to the company is concerned - thus trusteeship does not extend to third parties dealing with the company;

(b) directors are only liable to third parties if personal undertakings have been given by directors to a third party or where the memorandum of association states that the liability of the directors are unlimited.

[2](a) The duties of the directors should obviously be the same whether they are executive or non-executive; Courts of equity always tend to apply the label "trustees" to anyone in a fiduciary position;

(b) nevertheless, to describe the three directors as trustees seems, in the instant case, to be neither strictly correct nor invariably helpful.

[3](a) A director is not bound by law to give continuous attention to the affairs of his company; only he who is a majority shareholder does so;

(b) a director's duties are of an intermittent nature to be performed at periodical board meetings, and at meetings of any committee of the board upon which he happens to be placed;

(c) he is not, however, bound to attend all such meetings, though he ought to attend whenever in the circumstances he is reasonably able to do so;

(d) as such is the law, there is little that this Court can do to place the liabilities of "trusteeship" on the three defendants here.

[Order accordingly.]

Cases referred to:
Bath v. Standard Land Co. Ltd. [1911] 1 Ch 618
Lennard's Carrying Co. v. Asiatic Petroleum Co. Ltd. [1915] AC 705
Powell and Thomas v. Evan Jones & Co. [1905] 1 KB II
Regal (Hastings) Ltd. v. Gulliver & Ors. [1942] All ER 378
Salomon v. Salomon [1897] AC 22

Legislation referred to:
Companies Act 1965, s. 354(1)

Other sources referred to:
Halsbury's Laws of England, 4th Edn., at para. 771
Halsbury's Laws of England, Vol. 7, at p. 301, para. 517
Modern Company Law by L.C.B. Gower, 3rd Edn., p. 144
Principles of Company Law by H.A.J. Ford, p. 133

For the plaintiffs - Caroline C.K. Liau; M/s. Wong Yapp Chung & Co.
For the 1st & 2nd defendants - Catherine S.H. Yong; M/s. Michael K.M. Yong & Co.
For the 3rd defendant - Ken T.K. Chiam; M/s. Chin Lau Wong & Foo Co.

JUDGMENT

Syed Ahmad Idid JC:

The plaintiffs are a company incorporated in Malaysia with limited liability, with their registered office at 4th Floor, Wisma Equity, 150 Jalan Ampang, 50450 Kuala Lumpur, in the Federal Territory, Malaysia and are licensed insurers.

Keemenn & Associates Sdn. Bhd., are and were at all material times a company incorporated in Malaysia with limited liability with its registered office at 2nd Floor, Lot 2, Wisma HCS, Jalan Kolam, 88100 Kota Kinabalu, in the State of Sabah, Malaysia (hereinafter called "the company").

The 1st, 2nd and 3rd defendants are and were at all material times directors of the company.

The plaintiffs claim against the 1st, 2nd and 3rd defendants jointly and severally:

(a) A declaration that the 1st, 2nd and 3rd defendants jointly and severally hold the sum of Malaysian Ringgit Sixty Thousand Six Hundred Thirty Nine and cents Twenty Seven (RM60,639.27) as constructive trustees for the plaintiffs;

(b) An account and refund of the said sum of Malaysian Ringgit Sixty Thousand Six Hundred Thirty Nine and cents Twenty Seven (RM60,639.27) together with profits thereon;

(c) Interest thereon at the rate of 8% per annum from 14 January 1987 until judgment pursuant to s. 11 of the Civil Law Act 1956;

(d) Statutory interest thereon from judgment until realisation;

(e) Further or other relief;

(f) Costs.

1 April 1986 - Agreement appointing Keemenn & Associates Sdn. Bhd. (or "the company"), as the agent of Straits & Island Insurance Sdn. Bhd.

12 January 1987 - Sabah Marketing Corporation Sdn. Bhd.'s cheque on Hong Kong & Shanghai Banking Corporation No. 717523 for RM60,639.27 made out to Keemenn & Associates Sdn. Bhd.

15 January 1987 - Bank statement showing that the cheque had been deposited with Keemenn & Associates Sdn. Bhd.

14 January 1989 - Company search showing the 3rd defendant was a director of Keemenn & Associates Sdn. Bhd.

The 1st and 2nd defendants stated that:

(1) The relationship between the company and the plaintiffs was one debtor and creditor in respect of premiums for policies issued through the company.

(2) The company being in the nature of an ordinary trading company was not required under any law to operate a trust account in respect of monies receivable.

(3) By virtue of the above, the 1st and 2nd defendants denied that the company is a trustee in respect of monies receivable through its business, or that they were constructive trustees by virtue of their directorships of the company.

(4) Further, or in the alternative, they stated that the company was an independent legal entity accountable for its own liabilities. The 1st and 2nd defendants, being mere directors, were not liable for the company's debts nor were they under any duty to give preference to any debts of the company incurred in its business transactions.

(5) They had given no personal undertaking to the plaintiffs written or otherwise to bear and pay the company's debts and liabilities.

(6) The proper recourse for the plaintiff is a claim for debt against the company and not against the defendants as directors thereof.

(7) Counsel for 1st and 2nd defendants was of the view that the plaintiffs' only cause of action against the defendants was contained in one sweeping statement at para. 5 of their statement of claim:

> The 1st, 2nd and 3rd defendants are and were at all material times directors of the company and by virtue of their directorships were constructive trustee of the monies received by the company on behalf of the plaintiffs.

The 3rd defendant stated that:

(1) He was a Director of Keemenn & Associates Sdn. Bhd., but denied that he was a constructive trustee for the monies received by Keemenn and relied on s. 354(1) of the Companies Act 1965:

> 354(1) If in any proceeding for negligence default breach of duty or breach of trust against a person to whom this section applies it appears to the Court before which the proceedings are taken that he is or may be liable in respect thereof but that he has acted honestly and reasonably and that, having regard to all the circumstances of the case including those connected with his appointment, he ought fairly to be excused for the negligence default or breach the Court may relieve him either wholly or partly from his liability on such terms as the Court thinks fit.
>
> (2) At all material times he was working in Brunei and did not have the management of the company.
>
> (3) The statement of claim disclosed no reasonable cause of action against him.

The defence strongly urged the Court that a trust such as that envisaged by the plaintiffs had not been created between the plaintiffs and the company. The relationship was one of debtor and creditor. Even if a trust can be construed, the defendants were not personally liable for the company's undertakings nor were they under a duty to give preference to any particular creditor of the company. Even if there had been wrongdoing on the part of the directors of the company, the directors will be liable to the company and not to the plaintiffs who are third parties to whom the directors owe no direct duty.

It is also an established rule that even if a trust exists between the company and a third party, the directors of the company are not vicariously liable. The company is a separate entity from its directors. In *Halsbury's Laws of England* Vol. 7 at p. 301, para. 517, it is stated that:

> Directors are not trustees for the creditors of the company even as regards one to whom the company stands in a fiduciary relationship.

The case of *Bath v. Standard Land Co. Ltd.* [1911] 1 Ch 618 CA was also cited in support of this rule.

Directors are deemed to be constructive trustees only as far as their relationship to the company is concerned. Thus trusteeship does not extend to third parties dealing with the company. In the case of *Regal (Hastings) Ltd. v. Gulliver & Ors.* [1942] All ER 378 the **ratio** was that directors of a company stood in a fiduciary relationship to the company. The company in that case sued its directors as defendants. This ratio has so far not been extended to make directors of company stand in a fiduciary relationship to third parties. Can the three defendants be liable? They say they cannot be liable because they are not a party to the agency agreement and they had not given any personal undertaking to the plaintiffs.

The only exceptions where directors of a company are personally liable to third parties are:

> (i) where the directors give personal undertakings to the third party, that is a personal guarantee and indemnity; or
>
> (ii) where by the company's memorandum of association, the liability of the directors is stated to be unlimited.

Here, no guarantee/indemnity had been given by the defendants to the plaintiffs and the company's memorandum does not state that the directors' liability is unlimited.

The question of privity of contract is not relevant. This is clearly borne out by *Halsbury's Laws of England*, 4th Edn., at para. 771:

> 771. Fiduciary nature of relation. The relationship of agency is of a fiduciary nature. In some cases, commonly where property or money has been placed in the hands of the agent for a specific purpose, the agent becomes a trustee for his principal. In all cases the agent owes the principal duties of a fiduciary character, for example, to keep accounts, to disclose any conflict of interest and not to receive any secret commission or bribe.
>
> A sub-agent may also owe such duties even where there is no privity of contract between him and the principal if the sub-agent knows that the agent is acting for a principal and the principal assents to the employment of the sub-agent: *Powell and Thomas v. Evan Jones & Co.* [1905] 1 KB II, CA, where, however, it was considered that the relation of principal and agent in fact existed between the principal and sub-agent.

The 1st defendant was the managing director who signed the agency agreement on behalf of the company. It was submitted that by analogy, the directors are sub-agents.

Defendants' Counsel quoted Articles 2.2 and 3.1(iv) of the agency agreement, that is:

> (i) Legal relationship was of principal and independent contractor; and (ii) the agent (that is the company) agrees to collect all premiums and shall be liable to the (plaintiffs).

Plaintiffs' solicitors, on the other hand, urged the Court to accept in evidence Article 11.1 which is the relevant part to establish trust relationship:

> The agent agrees to place in trust and they pay to the insurer all monies received for any insurance business which is subject to this agreement and payments will be made in accordance with the credit period allowed under this agreement.

(ii) See also Article 3.1(iv):

> The agent agrees to collect all premiums on policies issued through his agency and he shall be liable to the company for the premiums due on all policies issued through his agency irrespective of whether or not payment is in fact received by him.

(iii) By Article 13.3:

> This agreement can be terminated immediately by the insurer giving written notice to the agent if: (i) in the insurer's indisputable opinion, the agent, or any of its officers or employees has been guilty of malpractice or misconduct;

The 3rd defendant, while he adopted some of the arguments put forth by 1st and 2nd defendants, added that he be relieved of any liability as he was away in Brunei. Section 354(1) of the Company Act was hailed for assistance:

> It was said in his favour that he acted honestly and reasonably he ought fairly to be excused Court may relieve him either wholly or partly from his liability.

It is interesting to note the trend from 1805 to 1975 in so far as liability of directors is concerned. Obviously, the landmark case of the company being a separate legal entity is *Salomon v. Salomon* [1897] AC 22. Since then Courts have put "life" into the corporations. There are manifest instances where people (so-called directors or partners) have misused and abused their position and hidden behind the separate identities of companies/ corporations. We all know of RM2 companies. Any Court which insists on merely following ancient precedents is not doing itself justice. The law must be alive, active and possibly though not prospective but at least abreast. As an illustration, in the electronics field and space explorations, the laws are not yet upto the speed at which developments in these areas take place so in our case here, I want to be as much up-to-date as possible. I shall not say I shall be bold. All we must do is to observe the trend and pick up what is best to suit the circumstances.

Companies Act through their directors. I was disappointed that this phase was not probed deeply to discover what the actual laws are. Indeed *Modern Company Law* by L.C.B. Gower, 3rd Edn., p. 144 says:

> But even English law stops short of recognising vicarious liability in all cases; sometimes it insists on personal fault as a prerequisite of liability. In such cases a corporation could never have been under any liability if the Courts had continued rigidly to apply the rule that the company has no person; it can only act through directors and the case is, as regards those directors, merely the ordinary case of principal and agent.' Hence the Courts have, once again, elected to treat the acts of certain officials as those of the company itself.

In *Bath v. Standard Land Co. Ltd.* [1910] 2 Ch 408, Neville J's *dictum* was recorded as:

> The board of directors are the brains and the only brains of the company which is the body and the company can and does act only through them.

Viscount Haldane LC, in delivering the judgment of the House said in *Lennard's Carrying Co. v. Asiatic Petroleum Co. Ltd.* [1915] AC 705:

> My Lords, a corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its active and directing will must consequently be sought in the person of somebody who for some purposes may be called an agent, but who is really the directing mind and will of the corporation, the very ego and centre of the personality of the corporation.

With directors of incorporated companies, the description "trustees" was less apposite but it was not unnatural that the Courts should extend it to them by analogy. For one thing, the duties of the directors should obviously be the same whether they are executive or non-executive; for another, Courts of equity always tend to apply the label "trustees' to anyone in a fiduciary position. Nevertheless, to describe the three directors as trustees seems in our instant case to be neither strictly correct nor invariably helpful.

A director is not bound by law to give continuous attention to the affairs of his company. Only he who is a majority shareholder does so. His duties are of an intermittent nature to be performed at periodical board meetings, and at meetings of any committee of the board upon which he happens to be placed. It is not surprising to hear of certain VIPs who sit on the boards of more than a dozen companies. He is not, however, bound to attend all such meetings, though he ought to attend whenever in the circumstances he is reasonably able to do so. As such is the law, there is little that this Court can do to place the liabilities of "trusteeship" on the three defendants here.

I am all for the proposition that:

> a Court will look behind the corporate entity to those who control it or hold shares in it in some situations even in the absence of legislative direction.

(page 133 of *Principles of Company Law* by H.A.J Ford) Courts are prepared to lift the veil of incorporation but this is limited in jurisdictions which practice English law such as ours. Some taxation statutes have regarded the controllers of a company and the corporate entity as identical. Sadly, I cannot take this stand here.

With the laws and precedents as they stand, and even accepting the facts, I have to decline granting the orders prayed for by plaintiffs. The "loss" by plaintiffs of the RM60,639.27 which is proved to have been credited to the company's account, of which the defendants were the directors, compels me not to order costs against them. Each party will bear his/their own costs.

Also found at [1991] 2 CLJ 1024